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Synopsis

Perspective—*Oil Price Cuts* [redacted] 25X1

The Gulf oil producers may not be able to stabilize the international oil market. Unless OPEC members can forge an effective production and pricing agreement quickly, oil prices could drop to $25 per barrel or lower. [redacted] 25X1

Japan: Protectionist Trends [redacted] 25X1

Although the Japanese Government has largely eliminated formal barriers to foreign trade, a wide variety of informal restrictions remain. Moreover, Japanese industrial policy has resulted in legislation and actions that are causing more problems for imports. [redacted] 25X1

Indonesia: Growing Strains in the Oil Sector [redacted] 25X1

The soft oil market is creating the most serious problems for Indonesia's oil industry since the near-bankruptcy of Pertamina (the state oil company) in 1975. [redacted] 25X1

Suriname: An Economy Under Siege [redacted] 25X1

The suspension of Dutch aid following the December executions of 15 leading critics of Suriname's Government is deepening the country's economic problems and raising the prospects for increased Cuban involvement. [redacted] 25X1

[redacted] 25X1

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Perspective

Oil Price Cuts

The Gulf oil producers may not be able to stabilize the international oil market. To do so they would have to come up with a new pricing structure and production allocation scheme agreeable to all members, particularly Nigeria. Iran could also be a spoiler. Unless something is worked out soon, a downward oil price spiral is substantially possible. Even if agreement is reached, it might not last very long if market speculators continue to unload inventories. If inventories were reduced to the level maintained relative to consumption in the early 1970s, they could be cut by about 400 million barrels. [redacted] 25X1

Last week's Nigerian $5.50 per barrel oil price cut resulted in downward pressure on oil prices as buyers delay liftings in anticipation of price adjustments by other producers. Lagos's threat to match any other price cuts also makes it likely that buyers will wait to increase their liftings of Nigerian crude for a week or so. Current OPEC production is running well below 16 million b/d with reports that output is as low as 13.5 million b/d. At the mid-February output level of 15.4 million b/d, buyers are depleting inventories at a rate of 5-6 million b/d given our estimate of 45-46 million b/d for present consumption. Although such rates of inventory depletion cannot be sustained indefinitely, companies can probably continue to postpone liftings for several more weeks before becoming concerned about stock levels. [redacted] 25X1

[redacted]

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It is not clear how quickly or by how much other producers will follow with cuts of their own. Mexico will reveal its new price structure at the end of this week, and Libya will be under great pressure to follow the Nigerian cuts. These countries currently have a combined surplus production capacity of about 1.5 million b/d. [redacted] 25X1

The Persian Gulf producers will adjust their $34 prices downward as well; a $4 cut has been mentioned most frequently, although rumors of cuts of $5.50 to $7 persist. Members of the Gulf Cooperation Council (GCC) met earlier this week and reportedly agreed on an unspecified price cut. OPEC GCC members were later joined by the oil ministers of Iraq, Libya, Venezuela and Indonesia to reach an OPEC-wide agreement on production and pricing. [redacted] 25X1

Given the Nigerian cut, a $30 benchmark would not be sustainable without agreement by Lagos to adhere to a production ceiling in the range of 1.2 to 1.3 million b/d. Buyers would prefer lifting Nigerian crude at the same price as Persian Gulf crudes because of its higher quality and lower transportation cost. As a result, in the absence of a production allocation accord, Persian Gulf producers would see little recovery in sales until all of Nigeria's surplus production capacity of 1.5 million b/d is exhausted. [redacted] 25X1

A cut of $5.50 per barrel would reestablish the recent price differentials between Arab Light and Nigerian crudes. Dropping the benchmark by $7 per barrel would realign differentials in accordance with Saudi preferences. We think that Riyadh believes this is about the price needed to further prevent sharp erosion to its oil share of the world energy market. The Saudis, therefore, probably see themselves caught between the need to cut prices for long-term oil market purposes and the need to avoid sparking a downward spiral. [redacted] 25X1

OPEC has announced that a ministerial meeting will be convened next week. Without an orderly approach to pricing decisions, market forces and buyer psychology will eventually pressure producers into a round of unilateral price cuts. Such cuts would do little to spark oil consumption and could easily cause a sharp downward pricing spiral as each producer tries to maintain market shares. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

OPEC Oil Production Plunges

As of mid-February, OPEC's crude oil production had fallen to 15.4 million b/d, down about 2 million b/d since January and the lowest level in over a decade. Production probably has continued to decline as companies postpone crude purchases and draw down inventories in anticipation of further price cuts. [redacted] 25X1

In Nigeria crude production fell to about 500,000 b/d before Lagos's unilateral decision to slash prices. The combined output of two other African producers—Libya and Algeria—has slipped some 300,000 b/d since January. Saudi Arabian ouput has dropped below 4 million b/d. Iranian production, however, has been holding steady, and Iranian Oil Ministry officials have expressed their intention to maintain high production levels to support an export plan of 2.5 million b/d. [redacted] 25X1

OPEC: Crude Oil Production *Million b/d*

	1982	1983	
		January	February [a]
Total	**18.8**	**17.2**	**15.4**
Algeria	0.6	0.7	0.6
Ecuador	0.2	0.2	0.2
Gabon	0.2	0.2	0.2
Indonesia	1.3	1.2	1.0
Iran	2.3	2.8	2.8
Iraq	1.0	0.8	0.8
Kuwait	0.7	0.6	0.6
Libya	1.2	1.4	1.2
Neutral Zone	0.3	0.3	0.3
Nigeria	1.3	0.8	0.5
Qatar	0.3	0.3	0.3
Saudi Arabia	6.3	4.7	3.8
UAE	1.2	1.1	1.1
Venezuela	1.9	2.1	2.0

[a] As of mid-February.

[redacted] 25X1

Discounts Minimize Impact of Oil Price Cuts

Because several OPEC countries have been discounting prices on large volumes of their oil exports—mainly through lower priced product sales—the expected official OPEC price cut on crude oil may not have much of an impact on total revenues. We estimate that more than one-third of OPEC oil exports are now being sold through methods that yield an effective crude price of about $6 below the $34 Saudi Light benchmark. For many producers a $4 marker cut probably would reduce oil revenues by about $1 per barrel. Several producers—including Algeria, Kuwait, and Venezuela—sell more than two-thirds of their oil exports as products that do not come under OPEC guidelines. Libya and Iran, which had a number of foreign crude processing deals, have recently been replacing them with crude sales whose value is based on the price received for product sales. Following Libya's success in marketing its crude, several other OPEC countries—including the UAE, Saudi Arabia, Nigeria, and Indonesia—have held discussions with international oil companies on crude sales prices based on product prices. 25X1

OPEC: Production and Discounted Oil Sales *Thousand b/d*

	February Crude Oil Production	Product and Discounted Crude Sales
OPEC	**15,400**	**5,510**
Algeria	600	450
Iran	2,800	2,100
Kuwait	600	450
Libya	1,200	600
Venezuela	2,000	1,410
Other	8,200	500

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Romanian Coal Problems Mount

A disappointing increase of only about 2.5 percent in Romanian coal output in 1982 has severely undercut President Ceausescu's plan to offset declining oil imports with huge increases in coal production. Output last year of 37.9 million tons fell short of the plan target by nearly 14 percent. The poor performance was not only a setback for Bucharest's annual target of 85 million tons of coal by 1985, but also well below the 7-percent average annual increase in coal output achieved during the preceding five-years. 25X1

To make up for the shortfalls, Bucharest recently set a goal of increasing 1983 coal production by 53 percent over 1982 levels. Energy guidelines for 1981-85 call for 60 percent of electricity to be generated with coal and shale by 1985, compared with about 40 percent in 1980. According to a recent press report, the regime hopes to achieve its goals by making the incomes of all miners dependent on the amount of coal they produce. The plans, however, probably will not be realized and will lead to a further slowdown in the rate of increase of industrial production, more grumbling among miners, and additional consumer inconvenience. 25X1

Shell To Cut Refining Capacity in Singapore

Royal Dutch Shell plans to reduce its crude oil refining capacity in Singapore by 46 percent, or 210,000 barrels per day. The reduction will trim Singapore's overall capacity by nearly 20 percent to some 900,000 b/d and cost the city-state some $600 million a year in net foreign exchange earnings. The cutback will begin as new Indonesian refining capacity becomes operational early next year. Indonesia is expanding three refineries to double the country's refining capacity and eliminate the need to ship crude oil to Singapore for processing into refined products for Indonesia's domestic market. 25X1

International Trade, Technology, and Finance

Canadian-Japanese Agreement on Auto Exports

Ottawa and Tokyo last week agreed to extend restrictions on Japanese automobile exports to Canada. The new agreement, covering the first six months of 1983, limits passenger car exports to 79,000 units, which represents a 3-percent increase annually over 1982 levels. Negotiations on export levels for the second half of 1983 are expected to begin soon. Industry analysts predict that new car sales in Canada will increase by 2 percent this year. Given the extremely low level of dealer inventories of Japanese cars, analysts estimate that Japan's share of the Canadian automobile market will drop from 25 percent to around 21.5 percent despite the increase in imports. Canadian UAW President White has nonetheless criticized the agreement because it allows additional imports at a time when the domestic automobile industry is severely depressed. He also is concerned that the agreement does not cover truck imports or Japanese investment in Canada's automobile industry. By limiting the agreement to six months, the Japanese have maintained the flexibility to increase imports in the second half if the market improves. 25X1

Danish Move To Abandon EC Sanctions

Recent action by the Danish parliament calls into question Copenhagen's further adherence to EC trade sanctions against the USSR. The sanctions, imposed by the EC Council in response to martial law in Poland, were extended an additional year in December. On 18 February, however, the Danish parliament's EC Committee voted against continuing the measures. Unless the full parliament approves legislation of its own to replace the EC Council regulation, Denmark will cease applying import restrictons on 1 March. 25X1

If Denmark reneges on the EC's sanctions policy, the Community could take Denmark before the EC Court or negotiate an exception similar to that granted Greece, which opposed the sanctions from the beginning. In either case the other eight EC members will continue the sanctions for the near term. Most agree that lifting the sanctions now, even though they are selective and largely symbolic, would send a wrong signal to Warsaw and Moscow. The next Council review will take place in two months, and Denmark's action could weaken EC resolve at that time. Moscow almost certainly will intensify its lobbying efforts with EC members to lift the sanctions as soon as possible. [redacted] 25X1

EC Proposes Raising Steel Production Quotas

The EC Commission has proposed raising the compulsory quotas on steel production for second-quarter 1983 by almost 2 percent above the current quarter's depressed level of 13.8 million tons. The Commission's decision is based on an expected modest recovery in the EC steel industry and an EC market forecast of a seasonal upturn in overall economic activity. The EC will consult with the steel industry and steel consumers next month before finalizing the quotas. [redacted] 25X1

Although the quota system recently has brought about an improvement in prices, the outlook remains discouraging for EC producers. The EC is attempting over the next two years to reduce steel capacity by nearly 18 percent—at a time when governments are trying to reduce unemployment—and failure of the expected economic recovery to materialize would force the Commission to revise the quotas downward. Any further cutback in the quotas probably would lead some producers to cheat on the system by lowering prices to maintain or boost production. [redacted] 25X1

European Community: Steel Production [a] *Thousand tons*

	1982				1983	
	I	II	III	IV	I	II
Total, actual	18,037	17,609	16,235			
Total, quota	18,574	18,699	17,541	16,676	15,881	14,027
Compulsory items	15,630	15,859	15,120	14,409	13,781	14,027
Voluntary items	2,944	2,840	2,421	2,267	2,100	

[a] Includes only steel production subject to EC quotas; this accounts for roughly 60-70 percent of total steel production in EC countries.

[redacted] 25X1

Tokyo Wants Review of Floating Exchange Rate System

At a press conference last week, Bank of Japan Governor Maekawa declared that the major industrial countries must study alternatives to the current exchange rate system. Maekawa claims that inflation and economic growth rates among industrialized nations are converging, obviating the need for a flexible, floating system of exchange rates. Earlier in February, Finance Minister Takeshita confided to US officials that he has doubts about the durability of the floating system. No consensus has emerged yet in Tokyo about the best replacement. Maekawa, however, opposes systems that specify a wide band of fluctuations for each national currency. [redacted] 25X1

National Developments

Developed Countries

Canadian Government's Offshore Oil Dispute With Newfoundland

The Newfoundland Supreme Court last week decided in favor of the federal government in its dispute with the Newfoundland provincial government over ownership and management of offshore oil and gas holdings. The court ruled that Newfoundland does not own the resources off its coast. Because of the dispute, oil and gas exploration in the area has been limited, and production from the 1.8-billion-barrel Hibernia oilfield, originally set to begin 1986, now has been delayed until 1989-90 and then only if a settlement is reached soon. [redacted] 25X1

While the ruling strengthens Ottawa's negotiating position, a quick settlement of the two-year-old dispute is not likely because of Newfoundland Premier Peckford's vow to continue the fight. Peckford intends to appeal the Newfoundland court ruling to the Supreme Court of Canada, which has already begun hearing a similar case on Newfoundland's offshore jurisdiction brought by the federal government. [redacted] 25X1

Less Developed Countries

Financial Assistance for Iraq

Iraq obtained a $90 million loan from the Arab Monetary Fund earlier this month to help cover foreign exchange outlays, according to the US Embassy in Abu Dhabi. Baghdad has received $200 million in direct aid from the United Arab Emirates thus far this year and may have obtained another $180 million from Saudi Arabia. It also has been promised $300 million from Kuwait and $500 million from an international banking syndicate. If Iraq receives these funds on schedule, financial aid this year would about match the monthly average for 1982 when Baghdad obtained over $5 billion in assistance. Even if the funds are received soon, bleak prospects for oil earnings will force Iraq to reduce its imports further. Baghdad almost certainly will have to lower its oil price and it has no way to increase production to compensate. [redacted] 25X1

[redacted] 25X1 25X1 25X1 25X1 25X1

Ethiopia Offers Foreign Investment Incentives

Ethiopia's Marxist government last month announced a series of incentives aimed at attracting much-needed private investment. A key element in the new package is an offer to set up joint ventures in which Addis Ababa would retain 51-percent participation. The government guarantees foreign ownership for 25 years and the repurchase of company shares at an equitable price. Additional inducements include a limited tax exclusion on imports and corporate income. In turn, foreign participants will be required to make investments in convertible currencies and fill the general or deputy manager positions with Ethiopian nationals. [redacted] 25X1

The new investment code took almost two years to prepare and was the subject of bitter debate within the Ethiopian Government, according to US Embassy sources. The decision to go ahead with the program suggests that Chairman Mengistu does not view his Soviet benefactors as playing a significant role in reviving the Ethiopian economy. We do not believe, however, that Mengistu has any intention of moving away from Moscow, whose military assistance is essential to the government's survival. Foreign investors probably will hold off until Addis Ababa pays off Western firms for assets nationalized by the government in 1974. [redacted] 25X1

Communist

Soviet Interest in New Grain Agreement With the United States

The director of the Soviet grain purchasing agency said publicly earlier this month that Moscow is ready to negotiate a new long-term grain trade agreement with the United States. He stated, however, that the USSR is unwilling to increase the minimum amount it has to buy above the current requirement of 6 million tons. [redacted] 25X1 25X1 the USSR may be more flexible than it has indicated publicly and may agree to some increase in the minimum requirements. The Soviets want to maintain an agreeemnt because the United States is the world's most stable producer and largest exporter of grain. Nevertheless, Moscow continues to view the United States as an unreliable supplier. Since the US embargo in 1980, the Soviets have diversified their sources of grain imports by entering into additional long-term agreements with other countries. [redacted] 25X1

Reduction in Soviet Winter Grains

Recent Soviet press reports state the area sown to winter grains is 3.5 million hectares, nearly 10 percent less than planned. The area—roughly 32.5 million hectares—is the smallest in 10 years. The Soviets say inadequate soil moisture at sowing time reduced the area planted. The press also reports plans to make up the deficit by increasing the area sown to spring grains. The high-yielding winter grains area of the Ukraine and North Caucasus was most affected. All-source weather data show near drought conditions there at sowing time last fall. The reduced plantings greatly lower prospects for winter grains, which usually make up nearly one-third of total production. The success of the plan to compensate for the winter grain shortfall by increasing the area sown to spring grains will depend on favorable weather this spring and on the availability of adequate seed and agricultural equipment. 25X1

Decrease in Polish Meat Supplies

The US Embassy reports that supplies of some foods, especially meat, decreased in February compared with last month, and lines for meat have reappeared. Meat supplies are lower because of distress slaughtering late last year caused by feed shortages. Supplies of bread and flour products have not declined because the regime was able to make cash purchases of small amounts of grain. Many consumer goods, especially shoes, are scarce, however, and are too expensive for the average Pole. 25X1

The meat supply situation will become steadily worse this year with per capita meat consumption likely to drop to the level of the early 1970s. Recent livestock statistics show that in January the number of cattle was down 4 percent compared with last year, of hogs 8 percent, and of sows 25 percent. Supplies of most manufactured consumer goods also will not increase significantly this year because of the low priority accorded such goods by the government. 25X1

Romania's 1982 Economic Results

Bucharest's efforts last year to ease its hard currency problems by reducing imports continued to take a toll on overall economic performance and consumer welfare. Although separate hard currency trade data have not yet been released, cuts in imports from the West—reflecting the regime's struggle to meet its obligations to Western creditors—almost certainly were the major factors in the 24-percent decline in overall imports last year. Exports, meanwhile, fell 10 percent. Official sources report that national income grew 2.6 percent and industrial production 3.3 percent. Both figures represented a slight increase from the record low postwar results posted in 1981, but they were well below long-term performance levels. Energy shortages continued to disrupt the economy as reductions in oil imports and slower rates of growth in domestic energy supplies curtailed generation of electricity. Agriculture was one of the few bright spots as the real value of agricultural production increased 7.6 percent after declines in the preceding two years. Consumers

bore the brunt of the Ceausescu regime's import cuts and economic austerity measures, as they experienced factory closings and layoffs, pay cuts resulting from unrealistic production targets, and the worst food shortages in over two decades. 25X1

Status of Cuban Debt Rescheduling

Cuba's government creditors expect debt rescheduling negotiations to be completed by early March, according to the US Embassy in Madrid. Official creditors, however, are showing some apprehension that the United States might attempt to participate by reviving its claims on some pre-Castro debts, which they believe would impede discussions. Cuba indicates it will not sit at the same table with the United States. Successful rescheduling probably would somewhat ease Cuba's ability to obtain short-term credits, thereby facilitating hard currency trade. Convertible currency constraints will persist, however, and force Cuba to continue buying less from the West. This, in turn, will lead to reduced economic growth and increased austerity. 25X1

New State Markets in Cuba

In an apparent attempt to increase the distribution of goods and reduce black-market activity and free market operations by farmers, the Castro regime is opening large supermarkets in Havana, some of which offer foodstuffs not available elsewhere. The US Interests Section in Havana reports that prices are high—comparable to those on the black market and farmers' free market—but that demand is brisk. Havana reportedly also plans to open several specialized retail outlets for such consumer items as clothing, shoes, hardware, jewelry, and household goods. 25X1

The new state markets probably are intended to improve consumer morale and productivity. They were opened soon after Cuba requested debt rescheduling from its Western creditors and while the public was being informed once again that it must sacrifice more and work harder. The scheme could backfire, however, if Havana is unable to keep the stores stocked. Cuban officials claim that hard currency constraints will not hinder their ability to stock the markets because most of the goods are produced in Cuba, the USSR, or Eastern Europe. Havana depends on hard currency imports for some of the materials used to produce these goods, however, and has few prospects for immediately improving foreign exchange earnings. 25X1

Japan: Protectionist Trends [redacted] 25X1

Although the Japanese Government has largely eliminated formal barriers to foreign trade, a wide variety of informal restrictions remain. Moreover, Japanese industrial policy has resulted in legislation and other actions that are causing new problems for imports. Without strong foreign pressure, we believe Tokyo will continue to erect new informal restrictions such as those embodied in legislation now being considered for aiding depressed industries. [redacted]

Removing Formal Barriers

Japan has dismantled most of its formal import restrictions over the last 20 years. Tokyo reduced the number of goods covered by import quotas from more than 250 in the mid-1960s to only 27 this year. Japan has agreed to cut duties on industrial products that [redacted] will lower the average Japanese tariff level on dutiable imports to 5.5 percent by 1987. In contrast, US tariffs will average 6.0 percent, compared with a pre-MTN level of 8.2 percent. [redacted]

Although quotas and tariffs do not present major problems in most cases, government controls on trading and government procurement are barriers for some industries. The government controls trading in a variety of products, including wheat, rice, barley, and tobacco. [redacted] these controls have not restrained imports of most of these state-traded items. Government regulation of manufactured tobacco products, however, has hurt the sale of US products. [redacted]

Tokyo has moved relatively slowly to liberalize government procurement procedures. Japan finally agreed to include Nippon Telephone and Telegraph (NTT) among the public corporations covered by the MTN code on government procurement in December 1980. As of September 1982, however, foreign contracts under the agreement were less than 1 percent of total NTT purchases. Similar results hold true in other areas of government procurement. [redacted] 25X1 25X1

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Tokyo has also been reluctant to liberalize its standards and approval procedures. Approval problems, such as unequal inspection systems, have inhibited US sales of consumer items and other products. The most recent example has been Japanese use of more costly inspection systems for imported metal softball bats than for bats produced in Japan. On other products, exporters to Japan charge that officials have deliberately delayed entry long enough to allow Japanese manufacturers to introduce a competitive product. [redacted] 25X1 25X1

One US study estimates the removal of remaining formal restrictions would add, at most, $2-3 billion to Japan's import bill, with half of the gain accruing to the United States. Our own estimates show similar results. For example, we project that if all agricultural quotas were eliminated, imports would increase by only $500-700 million. [redacted] 25X1 25X1 25X1

Informal Barriers

Japan maintains a wide array of informal trade barriers. Its close-knit industrial structure and complex distribution system are formidable obstacles to foreign competition. Major industries— 25X1

steel, automobiles, and segments of the electronics industry—are highly concentrated. The firms are frequently members of large, self-contained industrial groups—*keiretsu*—which provide most of their own raw materials, intermediate products, and marketing channels. *Keiretsu* members tend to purchase within the group unless market forces, particularly substantial price and quality differences, dictate otherwise. [redacted]

Japan's highly segmented, multilayered distribution system also tends to inhibit imports. High markups and distribution costs tend to decrease foreign competitiveness. For example, markups on foreign perfume add at least 50 percent to imported prices, while markups on domestic brands are about 35 percent. Even if foreign goods are price competitive, strong links between manufacturers, wholesalers, and retailers emphasizing stable supplies and reliable after-sales service have proved to be formidable obstacles. In addition, long-held cultural attitudes provide an important barrier. In many cases, foreign goods are considered luxury items and are bought only as gifts. [redacted]

Recent Government Policy Trends

Mainly in response to US pressure, Suzuki's administration put together trade packages in December 1981 and May 1982. The packages included an acceleration of tariff cuts agreed to in the Tokyo Round negotiations, unilateral reductions on some other items, a commitment to improve customs procedures, establishment of the Office of Trade Ombudsman to deal with foreign complaints, and foreign participation on standards drafting committees. [redacted]

Almost immediately after taking office in November, Prime Minister Nakasone asked the Cabinet to draw up measures to open the market further. The result was another package of tariff cuts in January, expanded quotas on agricultural products, an enhanced Office of Trade Ombudsman, promises to review all standards and certification systems, and measures designed to increase foreign sales of manufactured tobacco. [redacted]

Tokyo's efforts will have little visible impact on imports for some time, however. We believe the new tariff cuts will boost foreign purchases by no more than $1 billion over a 12-month period, less than 1 percent of last year's total import bill. About one-third of the increase would benefit US suppliers. If properly implemented, some of the measures, such as revising standards procedures, are potentially significant. At a minimum, some of the aggravation of doing business in Japan should be reduced, although foreign companies burned in the past are not likely to respond quickly to changes. [redacted]

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While taking steps to ease some barriers, Tokyo has failed to act on others:

- In negotiations this month, Japanese officials gave little ground on the issue of government procurement.
- While increasing relatively minor agricultural quotas, Japan has refused to budge on the major items such as beef and citrus quotas because of the political clout of the Japanese farmers in the ruling Liberal Democratic Party. [redacted]

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With local and national elections scheduled for this spring and summer and his political popularity slipping, we do not expect Nakasone to take significant action on sensitive trade issues. [redacted] public statements by Nakasone's Chief Cabinet Secretary, Masaharu Gotoda, suggest that revisions will fall short of US and EC expectations. [redacted]

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More Problems

Japanese industrial policy is perhaps the most significant barrier to imports, but its impact is impossible to quantify. Tokyo's efforts to funnel money into industries such as electronics has enhanced their competitiveness and retarded foreign access in certain key industries. [redacted] 25X1

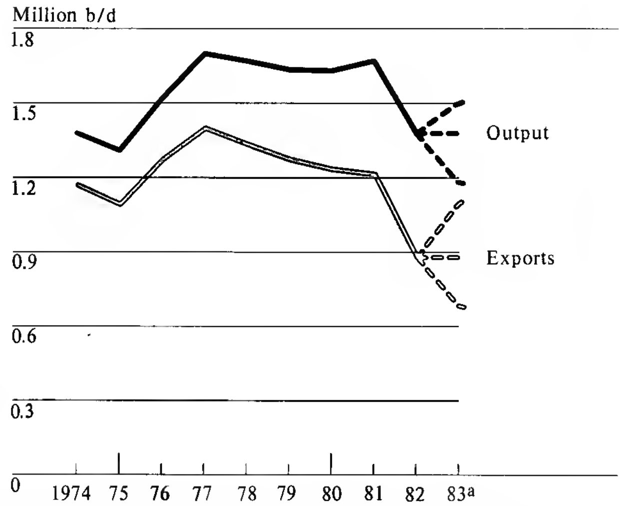
Moreover, Tokyo is considering a revision of the Aid to Depressed Industries Law that would keep the provisions of the current law and add financial and tax incentives for new technologies that would make these industries more competitive. The current Depressed Industries Law has allowed Tokyo to inhibit foreign inroads into the basic materials industries, such as aluminum smelting and petrochemicals. For example, MITI forced oil refiners to lower the price of naptha to increase the competitiveness of the domestic petrochemical industry.

[redacted] 25X1

Indonesia: Growing Strains in the Oil Sector [1] 25X1

The soft oil market is creating the most serious problems for Indonesia's oil industry since the near-bankruptcy of Pertamina (the state oil company) in 1975. Output slipped 500,000 b/d below capacity to 1.1 million b/d in January. We believe Indonesia's current account deficit in 1983 will be between $8-11 billion. Government officials, fearing a stiffening of lending terms by bankers later this year, are increasing foreign borrowing and are willing to pay interest rates considerably higher than those of a few months ago. 25X1

Indonesia: Crude Oil Output and Exports



a Projected. The upper limit represents the government's optimistic export and import goals. We believe earnings are likely to fall in the lower end of the range.

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External Strains

Through most of 1982 Japanese customers pressed Jakarta to match discounts granted by other OPEC (particularly Iran) and non-OPEC producers. In the face of the weakening oil market, Indonesia refused to cut prices. Modest reductions of $0.47-1.90 per barrel introduced in November were insufficient to sharply boost sales. Oil company representatives told US Embassy officials that price cuts of $2.50-4.00 per barrel would be required to make Indonesian crudes competitive.

As a result, Indonesia has been unable to sell all the crude oil it could produce. Buyers in Japan and the United States, which together take over 80 percent of Indonesia's oil exports, cut their combined purchases of Indonesian crude by 20 percent in 1982. Subsequently, output has fallen below 1.1 million b/d compared to Indonesia's OPEC quota of 1.3 million b/d and capacity of 1.6 million b/d.

Jakarta so far has not allowed its oil production and marketing problems to sour relations with other OPEC members. Indonesia has continued to follow the lead of Saudi Arabia and Kuwait on prices while seeking a compromise on pricing and production among OPEC's various factions. Indonesia went into the December 1982 OPEC meeting in Vienna wanting a 200,000 b/d increase in its production quota. Although the meeting collapsed without agreement on new production quotas or differentials, Mining Minister Subroto told one press reporter that Indonesia's output would be held at 1.3 million b/d. In our judgment, the Indonesians remain committed to seeking a compromise on output quotas within OPEC because they fear a reduction in OPEC's official price could lead to a downward price spiral. 25X1

[1] This article is a summary of a forthcoming Intelligence Assessment.

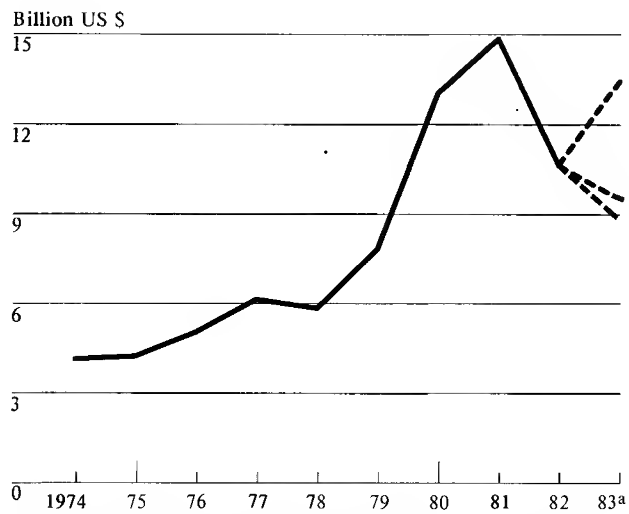
The Tougher Domestic Operating Environment

Foreign oil companies in Indonesia have found the local operating environment toughening. Pertamina's new president, Judo Sumbono, who was appointed in May 1981, has been more confrontational than his predecessor toward the foreign oil companies, which account for over 90 percent of Indonesia's crude oil output. Under Sumbono, Pertamina is requiring that a field contain sufficient recoverable reserves to supply the government with at least 51 percent of the recoverable oil. On several occasions since mid-1981, Pertamina has refused to declare new fields commercial, thus preventing the companies from beginning production and recovering their exploration costs. Because Indonesia has numerous small fields, Pertamina officials have told news reporters they expect similar disputes in the future. [redacted]

The Caltex Negotiations

Caltex, the largest oil producer in Indonesia, currently is negotiating terms for a new production-sharing contract to become effective in November. Indonesian officials are trying to increase the country's share of Caltex's production above the 85-percent government share of all other production-sharing contracts. The Indonesians have proposed a three-tiered approach that includes the standard 85- to 15-percent production-sharing split for the first 150,000 b/d of output, then 90 percent to 10 percent for the next 100,000 b/d, and 95 percent to 5 percent for amounts in excess of 250,000 b/d. This arrangement would give Pertamina over 90 percent of Caltex production. Although Caltex officials are balking at the 95- to 5-percent part of the formula, we believe the two parties will compromise on some escalation formula before the November expiration date to avoid jeopardizing production. Press reports indicate that other oil companies are monitoring the negotiations to determine whether Pertamina might use the Caltex negotiations as a precedent to change the terms of their contracts. [redacted]

Indonesia: Oil Export Earnings



[a] Projected. The upper limit represents the government's optimistic forecast. We believe earnings are likely to fall in the lower end of the range.

[redacted]

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Rough Year Ahead for Oil

Indonesia and the World Market. Current conditions in the world oil market promise continuing weakness in Indonesia's oil export earnings. Indonesia will do well to restore production to 1.3 million b/d this year. We believe Jakarta will match any drop in official sales prices by other OPEC members and would probably match any unofficial discounts to maintain its market share despite the impact on revenues. At 1982 export volumes, each $1 per barrel drop in price would reduce earnings by $320 million a year. [redacted]

Grim Financial Prospects. The government has yet to cope with the decline in oil earnings. President Soeharto has cut subsidies for food, fuel, and fertilizers, frozen civil servant and military wages, and cut other spending. Stiffer austerity measures,

however, including cuts in the country's previously sacrosant industrial development programs, will be necessary to avert a financial crisis resulting from the prolonged slump in foreign exchange earnings.

We estimate Indonesia ran a $7.4 billion current account deficit in 1982 and will probably do worse this year. Even if the oil market were to rebound somewhat, Indonesia would face a $6 billion current account deficit this year. This projection assumes a modest recovery in nonoil exports, a sharp reduction in import growth to 8 percent in 1983, and a very optimistic oil sector scenario that calls for a 225,000-b/d increase in exports to 1.1 million b/d at the 1982 price level of $33.60 per barrel. More likely in our judgment is a further softening in the world oil market that would lower oil earnings and push Indonesia's current account deficit into the $8-11 billion range.

In any event, Jakarta is already increasing its foreign borrowing to help finance this year's deficit. After reducing foreign exchange reserves by nearly $3.5 billion in 1982, in our judgment Jakarta would prefer to avoid reducing official reserves sharply below the current level of $4 billion. Press reports reveal that Central Bank officials are arranging a $1 billion loan, and they expect to borrow more later this year. To get the loan, Jakarta is offering a considerably higher interest rate than it was willing to accept last year.

The Threat to Exploration

We believe that exploration will continue to fall in 1983. According to the US Embassy, foreign companies drilled only 149 exploration wells through October 1982 out of 266 projected for the year and cut back on seismic surveys. Companies have also reduced the bonuses they pay when signing exploration contracts.

We believe Jakarta's efforts to spur exploration will be weakened by the government's plans to transfer all onshore drilling operations to Indonesian firms within the next two years and to press ahead with plans to force oil companies to hire Indonesians for skilled positions. In addition, lower oil company profit margins suggest that companies are likely to take a much more cautious approach to new spending commitments in Indonesia. Oil company representatives have told US Embassy officials that cash flow problems of their parent companies are forcing slowdowns in their Indonesian operations and elimination of marginal projects.

A slowdown in oil exploration would seriously affect Indonesia's oil production capacity later in the 1980s, in our judgment. Most of Indonesia's oil deposits occur in small reservoirs that are quickly depleted, and active exploration programs are necessary to maintain the country's production capacity.

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Suriname: An Economy Under Siege [redacted]

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The suspension of Dutch aid following the December executions of 15 leading critics of Suriname's government is deepening the country's economic problems and raising the prospects for increased Cuban involvement. The Bouterse regime's frantic search for funds from several Latin American countries so far has been futile as these countries grapple with their own financial difficulties. With cautious spending, Suriname probably has sufficient reserves to tide its import-dependent economy over the next few months. Tougher austerity measures will be needed, however, should replacement aid not materialize by mid-1983. The regime's clumsy handling of the economy and its leftist bent suggest that any belt tightening will be haphazard, with the business community bearing the brunt of probable tax hikes and domestic credit restrictions. [redacted]

Economic Slide Since the 1980 Coup

Under the tutelage of the Dutch, who provided the lion's share of foreign aid, Suriname managed to achieve robust economic growth during the initial years following independence in 1975. The tiny economy's heavy dependence on aluminum, however, left Suriname vulnerable to the global recession and soft demand for this metal. Meanwhile, weakening business confidence in the coalition government's ability to rule slowed investment. In these circumstances, real GDP growth declined 3 percent in 1979. [redacted]

The military-dominated government in place since a group of noncommissioned officers seized power in February 1980 was unable to brake the economic decline that began in 1979. In 1980 real GDP fell almost 4 percent, and the economy stagnated over the next two years. A 35-percent drop in bauxite output—owing to continuing world recession and rising production costs—and the worsening investment climate at home drove this poor performance between 1980 and 1982. Only the public sector showed strong growth. Even then, government expenditures were directed more toward consumption than toward growth-sustaining investment. [redacted] 25X1

The government's limited ability to prepare and implement development projects increasingly constrained growth. Mismanagement, caused by a shortage of technical and managerial talent in government, badly delayed aid disbursements. Suriname's weakening competitive position in a softening world aluminum market also caused the government to shift its development strategy. In 1981 the regime scuttled large bauxite and aluminum smelter undertakings, the Kabalebo hydroelectric project, and construction of a new port. 25X1 Less ambitious agricultural projects, which would provide quick benefits to small farmers, were left intact. Output in the agricultural sector nudged ahead, based primarily on expanded acreage cultivated for export-oriented rice and palm oil, but high labor and transport costs continued to undermine Suriname's international competitiveness. [redacted]

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At the same time, the regime's increasingly leftist tone and increasingly erratic approach to decision-making started to alarm the business community. Under the process of "Surinamization" (nationalization or joint ventures with government participation), the state expanded its involvement in the economy. 25X1 Constrained by fixed prices, key commercial enterprises with government participation—such as sugar, shipping, and electricity—last year alone required some $50 million in subsidies to offset operating losses. [redacted] 25X1

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25 February 1983

The Economy in a Nutshell

Suriname shares many of the economic constraints common to the Caribbean area:

- *High import dependence that leaves the country vulnerable to world inflationary trends and complicates domestic economic management; imports are equivalent to 45 percent of GDP.*

- *A one-commodity economy that holds the country hostage to world mineral prices; production of bauxite, alumina, and aluminum provide 80 percent of total export earnings, nearly 20 percent of GDP, and over 20 percent of government revenues.*

- *A tiny domestic market that crimps development of the manufacturing sector; Suriname's population totals only 350,000.*

- *Substantial emigration that helps to relieve high unemployment yet saps the country of skilled labor; at least one out of every three Surinamers lives in the Netherlands. Despite emigration, unemployment is around 20 percent, supported by an influx of Guyanese workers.*

- *An agricultural sector that contributes less than 10 percent of GDP; farming is handicapped by high labor costs and poor utilization of existing resources; dense rainforests cover 90 percent of the country, while large tracts of cultivated land have been left fallow by the steady exodus of Surinamese and Dutch plantation owners.* [redacted] 25X1

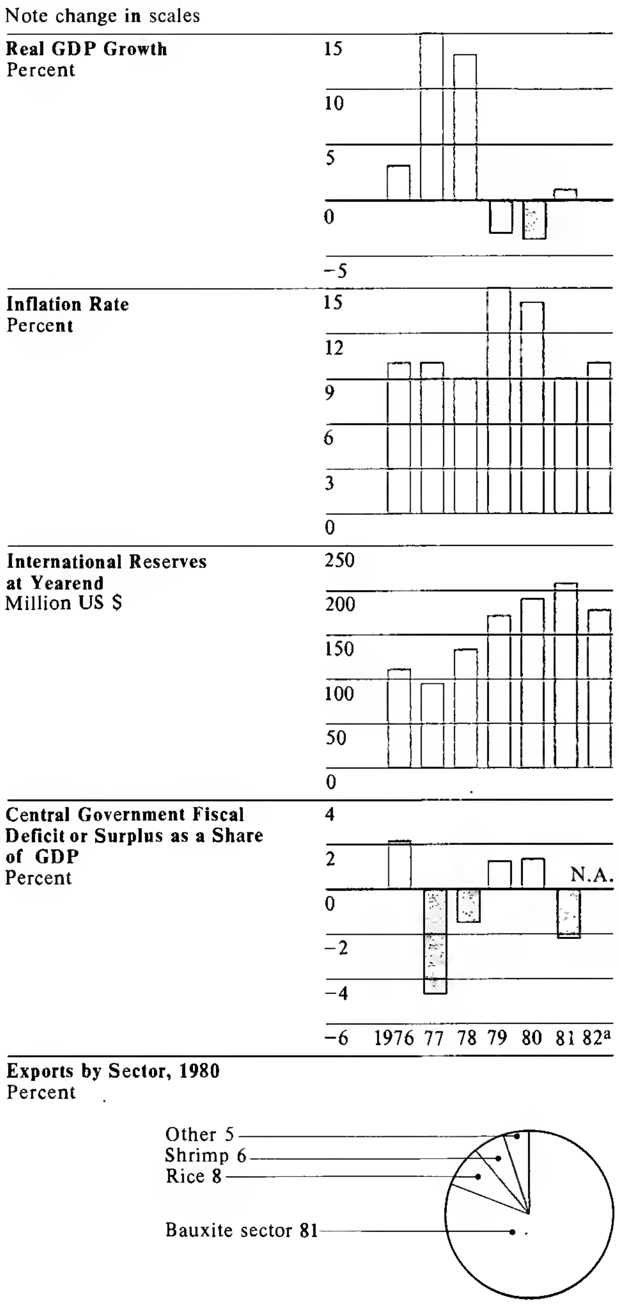
Dutch aid until recently had cushioned Suriname from the severity of economic problems besetting its Caribbean neighbors. At the time of Suriname's independence in 1975, the Netherlands forgave all outstanding Surinamese debt and agreed to supply more than $1.5 billion in aid—about one and a half years' worth of GDP—over a 10- to 15-year period. This largess enabled Suriname to mount extensive rural development and hydroelectric projects while balancing government budgets and maintaining large foreign reserve holdings and a low debt service burden. At the same time, the aid inflows, combined with large-scale emigration, contributed to a per capita income that was among the highest in the non-oil-exporting Caribbean countries and more than double that of bauxite-rich Guyana or Jamaica. [redacted] 25X1

The foreign trade picture also deteriorated; in 1981 Suriname had its first balance-of-payments deficit in five years. Spot world aluminum prices plummeted over 40 percent between 1980 and 1982. Led by the aluminum industry, nominal export earnings fell 15 percent during this period. Meanwhile, foreign aid slackened as project priorities were reshuffled. Rather than deplete its international reserves or resort to a devaluation that would have reduced foreign purchases of critical producer goods, the regime selectively tightened import restrictions on consumer goods. Consequently, according to official Surinamese reporting, the country retained international reserve holdings that were roughly equivalent to about four months' import coverage at yearend 1982. [redacted] 25X1

Gloomy Outlook in 1983

Meeting Economic Needs. The regime's most pressing economic needs are to find replacement aid and to reassure the country's nervous business community. Until the Netherlands suspended aid following the December executions, the Dutch had accounted for more than 90 percent of total bilateral aid to Suriname. Dutch aid had been scheduled to reach some $90 million this year; more than half of the $1.5 billion package promised in 1975 remains to be drawn. Led by the United States, most other Western donors have suspended their small programs in response to the regime's brutal handling of its opponents. We believe private capital

Suriname: Economic Indicators



[a] Estimated.

[redacted]

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flight continues to drain Suriname's international reserves despite the recent banking clampdown. [redacted] 25X1

The chilling effect of Bouterse's increasingly heavyhanded tactics to quell dissent and to consolidate his power will make future aid unlikely. The regime's frantic search for aid, trade, and technical cooperation—aimed mainly at Brazil, Venezuela, Colombia, and other Latin American countries—is likely to prove disappointing. These countries are suffering from serious financial troubles and seem reluctant to support the Bouterse regime. [redacted] 25X1

While prudent management would allow Suriname to muddle through the next few months, probable economic bungling could amplify problems late and make the course of the economy through the rest of 1983 harder to predict. Much also will depend on Bouterse's staying power. [redacted] 25X1 25X1 the Netherlands has indicated a willingness to resume a dialogue with Surinamese officials only with the removal of Bouterse—even if the next leader is farther to the left—and with the return of Suriname to constitutional government. By brutally eliminating his main opponents and intimidating important elements of society, however, Bouterse has reduced the chance of an internal uprising any time soon. He will remain vulnerable to an externally launched attack, but the exile groups appear disorganized and ineffective. [redacted] 25X1

If the regime consolidates its power, the Surinamese economy can be expected to become the chink in Bouterse's armor. Even with aid later this year, the Surinamese economy at best will stagnate in 1983. Weak world recovery and inherent lags in the recovery of aluminum demand will leave export earnings at about last year's level. Moreover, project aid would be especially hard to restore quickly to the levels originally planned. [redacted] 25X1

Alternatively, if the near-total cutoff in Western aid continues, Suriname would have to enact more import cuts and adopt fiscal austerity measures

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Suriname: Balance of Payments *Million US $*

	1976	1977	1978	1979	1980	1981	1982 [a]	1983 [b]
Current account	**63**	**−4**	**28**	**44**	**16**	**−25**	**−68**	**−75**
Trade balance	45	22	68	74	61	−38	−76	−5
Exports, f.o.b.	304	346	411	444	515	474	434	430
Bauxite and derivatives	235	277	310	341	415	376	344	340
Imports, f.o.b.	259	324	343	370	454	512	510	435
Net services and transfers	18	−26	−40	−30	−45	13	8	−70
Grants from the Netherlands	89	77	56	81	74	96	90	0
Capital account	**−38**	**−12**	**−10**	**− 6**	**3**	**43**	**37**	**−30**
Net direct investment	NEGL	−13	−7	−16	10	34	NA	−5
Medium- and long-term loans	−55	NEGL	22	−1	NEGL	−1	NA	25
Net short-term capital, including errors and omissions	17	1	−5	11	−7	10	NA	−50
Change in gross reserves	**25**	**−16**	**38**	**38**	**19**	**18**	**−31**	**−105**

[a] Estimated.
[b] Projected on the basis of a near total cutoff in Western aid, private capital flight of $70 million, and a drawdown on gross reserves to the equivalent of two months' import coverage.

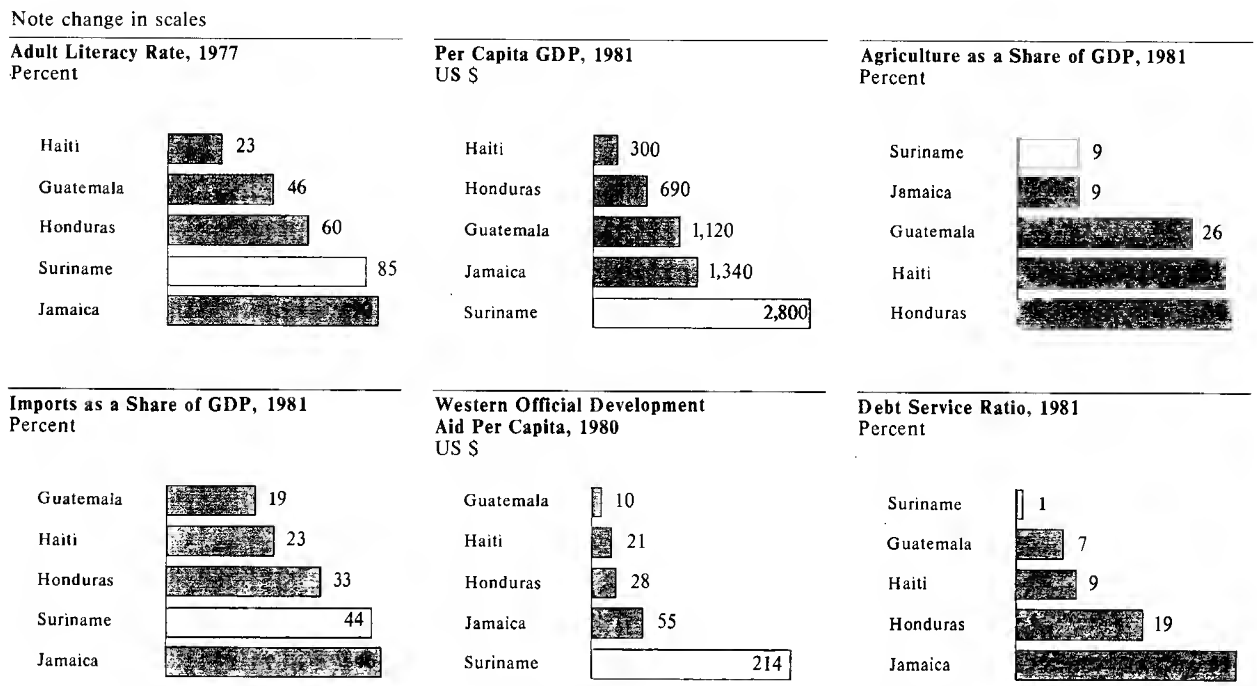
[redacted] 25X1

that would cause a sharp economic decline. Emigration, mainly to the Netherlands, neighboring French Guiana, and the Netherland Antilles, would rise even faster as many of the 6,000 workers assigned to Dutch-financed projects are laid off. Although this exodus will help to vent political frustration and cap unemployment, it will further drain the availability of skilled labor needed to maintain economic activity. [redacted] 25X1

Threats to the Private Sector. We believe Bouterse's political insecurity and reliance on a shrinking circle of advisers probably will cause him to take heavyhanded actions. The deteriorating economy could goad him into both cajoling and threatening the business community in the coming months; businessmen already have been asked to donate $300,000 to the coup anniversary celebrations this week and have been prohibited from laying off employees. [redacted] 25X1

Although some of Bouterse's closest advisers apparently espouse nationalization of foreign firms, we think that the soft world aluminum market, lack of skilled technicians, and steep modernization costs will cause Bouterse to resist such measures for now. Ongoing tax negotiations between the regime and the aluminum companies have been acrimonious and could provide the first real test of Bouterse's intentions toward them. While the regime may unilaterally hike bauxite levies as a quick revenue fix, this action would be shortsighted. More than 90 percent of Suriname's bauxite exports and 40 percent of its alumina sales are directed toward the United States and the Netherlands. Both countries could easily shift to alternative suppliers. Large stockpiles overhanging the world aluminum market would make it hard for Suriname to find other buyers. [redacted] 25X1

Suriname: Economic Comparisons



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Opportunities for Cuban Mischief. Bouterse already has warned publicly that he will seek aid from the Soviet Bloc should his demarches to Western countries not pan out. [redacted] After a military coup almost succeeded in March 1982, Bouterse turned to Havana for political support. Exploiting Bouterse's growing isolation and sense of insecurity, Cuba has gained considerable influence and is likely to press for more. The Cuban Ambassador to Suriname recently stated that Cuba wants to increase trade with that country. The Soviet Ambassador to Suriname has expressed interest in a possible barter in which Surinamese rice and lumber would be delivered to Cuba to save costs in shipping Soviet supplies. In exchange, Soviet vehicles, consumer goods, and possibly light machinery would be sent to Suriname. [redacted] 25X1

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We believe Bouterse's reliance on the Cubans will continue as long as he believes his domestic position is insecure and Havana is not perceived to be acting against his interests. [redacted] 25X1 25X1 [redacted] Cuba does not want to provide much economic support to Suriname because of its own economic problems and a concern that Bouterse's revolution may be reversed. Moreover, Havana is acting cautiously to avoid jeopardizing its recent efforts to improve relations with several South

American countries and to avoid alienating Western powers as Cuba attempts to renegotiate its debt. Under these circumstances, the Castro regime probably will pursue a low-key expansion of its influence. We believe Cuban influence in Suriname would expand faster if Bouterse or another leftist leader could demonstrate a firmer grip on power. [redacted] 25X1 25X1

Lasting Economic Problems. Even with political stabilization and a reopening of the aid spigot, a variety of factors probably would prevent a return in the next few years to the high growth rates that the country enjoyed following independence. Despite the rise in aluminum prices that probably would accompany world economic recovery, earnings from the aluminum sector will be constrained by a diminishing supply of easily accessible bauxite, high operating expenses, and steep modernization costs. Moreover, economic diversification will be harder than in the past. The shrinking domestic market will dampen further development of food processing and other light industries. Surinamese businessmen, foreign investors, and potential donors understandably will be cautious and probably will not undertake many projects until they can be assured of long-term political stability. In addition, the flight of technical and managerial talent will have lasting repercussions throughout the economy. [redacted] 25X1

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